APPENDIX.

COMMENTS ON RECENT DECISIONS.

BANKRUPTCY—*Title of the Trustee in Bankruptcy to Bankrupt's Interest.*

Under a Trust (Illinois). Dorothea W. Huszagh was the owner of a vested interest under a trust created by the terms of her father's will. In October, 1939, James R. Cardwell, a judgment creditor of Mrs. Huszagh, filed a bill in the Circuit court of Lake county for the purpose of reaching that interest. The Circuit court, holding that the trust in question was not a spendthrift trust, entered a decree of sale. Within a week following the decree the litigants reached an agreement that Cardwell would, at the sale, bid the full amount of the judgment in return for Mrs. Huszagh's forebearance to appeal. Pursuant to this agreement, Cardwell bid the full amount of the judgment at the master's sale thereafter held, and became the successful bidder and owner of the interest in the trust. A satisfaction piece was filed of record.

About a year later Mrs. Huszagh was adjudicated bankrupt on her voluntary petition. On his appointment as trustee in bankruptcy, Fred E. Hummel filed a bill of review in the Circuit court of Lake county, seeking to have the court set aside the previous decrees and to have the bankrupt restored to her former status (as owner of the interest in the trust). The bill was based on the ground that there was error apparent on the face of the record because the decrees were in contravention to § 49 of the Illinois Chancery Act[1] which provides that after an execu-

1. Sec. 49, Ch. 22, Ill. Rev. Stats.

tion has been issued discovery may be compelled against the debtor as to, and the court shall have power to decree satisfaction out of * * * "property, money or things in action, belonging to the defendant, or held in trust for him * * * except when such trust has, in good faith, been created by * * * some person other than the defendant himself * * *." This statute has been interpreted by the Illinois Supreme court to permit voluntary transfer by the beneficiary in absence of an express restraint against same in trust instrument.[2]

Mrs. Huszagh, Cardwell, and the trustee under the will were named as defendants. All filed answers and Mrs. Huszagh filed a counterclaim. The Circuit court dismissed both the bill of review and the counterclaim. On appeal, the Appellate court of the Second district reversed the order dismissing the bill of review and issued an order of remandment, directing that the sale be vacated and that Mrs. Huszagh be restored as the beneficiary under the trust. On appeal to the Supreme court, *Held* reversed. The court held the contention that the trust was controlled by § 49 of the Chancery Act to be correct since the trust in question had been created by another than the bankrupt, and admitted that there was error apparent on the face of the record. It concluded, however, that the interest of the trustee in bankruptcy was limited to the interest which a judgment creditor could have acquired and no more,[3] and

2. In *Binns* v. *LaForge*, 191 Ill. 598 (1901) the S. Ct. of Ill., interpreting this section of the Chancery Act, stated that the statute was not designed to protect the trust from voluntary alienation of the *cestui que* trust. Apparently its purpose is to protect such trusts as herein considered from being reached by judgment creditors.

3. The court cited, in support of this holding, section 70, sub. c, of the Bankruptcy Act. Examination of this portion of the act reveals that it grants to the trustee the rights, remedies, and powers of a judgment creditor, but nothing in the language therein appears to constitute a limitation to such right and no more. In apparently the only other Illinois decision interpreting this portion of the subsection its purpose as stated was to prevent a defense that the bankrupt was in *pari delicto* to the party sued and to give the trustee greater powers than the bankrupt had held. *Chatz* v. *Bloom*, 322 Ill. App. 435, 54 N. E. 2d 889 (1944).

held that since the judgment creditor, under the terms of § 49 of the Chancery Act, was without power to reach the interest, the trustee in bankruptcy was likewise limited and could not be preferred over the judgment creditor. The counterclaim was dismissed on grounds of estoppel because of the agreement entered into by the judgment creditor and the judgment debtor, which had been performed by the judgment creditor. *Hummel* v. *Cardwell*, 390 Ill. 526, 62 N. E. (2d) 433 (1945).

The dismissal of the bill is not without adequate support, for the title of the trustee in bankruptcy is generally limited to that which the bankrupt held at the time of the filing of the petition[4] and since the court determined that the bankrupt herself could not claim any interest under the trust, because of her agreement with the judgment creditor, there was no title in the bankrupt to which the trustee could succeed. Also, though the trustee may set aside any preferential judgments under § 60 of the Bankruptcy Act, action to do so must be instituted within four months from the date of the judgment or date of the record thereof, and in this case action by the trustee was barred by this limitation.

However, it would appear that the basis of the decision is in fact the court's interpretation of the Bankruptcy Act to the effect that where a judgment creditor is denied the right of satisfaction of execution on property held in trust for the bankrupt or, in other words, where such property is not subject to levy and sale under judicial process, it does not pass to the trustee in bankruptcy, no consideration being given to whether the property was or was not subject to voluntary alienation by the bankrupt. This view is not supported by either the terms of the Bankruptcy Act or the cases on the question.

4. U.S.C. Title 11, Sec. 60. Also see Decennial Digests, Bankruptcy, Key 151.

The test of whether or not property of the bankrupt passes to the trustee is found in § 70 of the Bankruptcy Act.[5] Subsection a, (5) of § 70 provides that "The trustee of the estate of a bankrupt * * * shall in turn be vested by operation of law with the title of the bankrupt to all * * * property, including rights of action, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him or otherwise seized, impounded, or sequestered." This clear language of the statute itself indicates that the test is *twofold*, and if the property meets *either* the requirement of being subject to levy and sale under judicial process *or* the requirement of being subject to voluntary alienation by the bankrupt, then the title thereto passes to the trustee.

The same view is found in the decisions. In *In re Landis*,[6] a federal decision on a case arising in Illinois, the court held that title to an interest in land, assumed to be a contingent remainder, which was not, under the laws of Illinois, subject to levy and sale under judicial process, nevertheless passed to the trustee of the bankrupt by reason of the fact that it was transferable by him. The opinion states clearly that under § 70, a, (5) of the Bankruptcy Act two classes of property were set up; first, property which is transferable, and second, property which is subject to levy and sale under judicial process. In *Suskin & Berry* v. *Rumley*,[7] an earlier federal decision, the court, though deciding that the interest of the bankrupt did not pass to the trustee, based its decision on two separate and distinct reasons; the one, that the property was not subject to levy and sale under judicial process, the other, that it was not transferable by the bankrupt. In a N. Y. case where the bankrupt was the beneficiary of a

5. U.S.C. Title 11, Sec. 110. See also U.S.C.A. Title 11, Sec. 110, note 191 and cases cited therein.

6. 41 F. 2d 700 (1930) (see also 138 A.L.R. 1350).

7. 37 F. 2d 304, 68 A.L.R. 769 (1930).

testamentary annuity out of a trust fund it was held that the right of the beneficiary was property which he could assign and which could be followed by his creditors and therefore passed to his trustee in bankruptcy.[8]

Indeed, other of the cases would indicate, if considered individually, that transferability alone is the test. In *Pollack* v. *Meyer Bros. Drug Co.*,[9] the court declared that the question of whether the property was subject to seizure was not the test, and pointed out that many equitable interests are not subject to seizure or execution, but being transferable pass to the trustee in bankruptcy, citing as examples thereof, a seat on a stock exchange,[10] liquor license,[11] and certain insurance policies.[12] In *In re Wright*[13] the question of whether a bankrupt's interest in commissions on renewal premiums to which he was entitled under contract was property which passed to the trustee was decided solely on the fact that it was transferable.[14]

Patrick v. *Beatty*,[15] a North Carolina case is a very good example of the test as it might well have been applied by the Illinois court in arriving at the proper interpretation of the act. In that case it was held that the bankrupt's interest in an estate in trust could not have been sold upon judicial sale under the laws of North Carolina, since it was a spendthrift trust so far as creditors were concerned, yet because it was alienable by the beneficiary it passed to the trustee in bankruptcy.

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8. *In re Burtis*, 188 F. 527 (1911). See also U.S.C.A., Title 11, sec. 110, note 194 and cases cited therein.

9. 233 F. 861, 147 C.C.A. 535 (1916).

10. *Page* v. *Edmonds*, 187 U.S. 596, 23 S. Ct. 200, 47 L. Ed. 318 (1903).

11. *Fisher* v. *Cushman*, 103 F. 860, 43 C.C.A. 51, L.R.A. 292 (1900).

12. *In re Coleman*, 136 F. 818, 69 C.C.A. 496 (1905). *In re White*, 174 F. 333, 98 C.C.A. 205, 26 L.R.A. (N.S.) 451 (1909).

13. 157 F. 544, 18 L.R.A. (N.S.) 193 (1907).

14. See *Horton* v. *Moore*, 110 F. 2d 189 (1940) where it is said that that transferability is the test under the plain language of the act. In this case a contingent remainder in a trust passed to trustee because it was transferable under the laws of Michigan, the court adding that even a possibility coupled with an interest may pass since under local laws they are assignable.

15. 202 N.C. 454, 163 S. E. 572, 20 Am. Bankr. Rep. (N.S.) 673 (1932).

In *Martin* v. *McCune*,[16] decided by the Illinois Supreme court in 1925, the vested interest of the bankrupt under a trust passed to the trustee in bankruptcy, the court in that case apparently finding no necessity for any interpretation of the Bankruptcy Act such as given in *Hummel* v. *Cardwell*.

In reaching its decision in *Hummel* v. *Cardwell* the court relied also on the proposition that state law controls in the matter of interpretation of property rights. That is certainly the correct rule but the question on which the state Beloit were not unreasonable. The include the rates of the law is held to be controlling is that of whether or not the property is, under the local law, subject to seizure or transferable.[17] That state law controls in the interpretation of property rights does not *affect* the test, but is rather in substance a statement of the test.[18]

The court's interpretation of the Bankruptcy Act entirely ignores the question of voluntary transferability as a test of the problem whether property of the bankrupt passes to the trustee. Unless both tests above stated are applied and it is determined that the property is *neither* subject to levy and sale under judicial process *nor* subject to alienation by the bankrupt, a conclusion to the effect that the property does not pass is not in accord with either the statute itself or with the decisions. The application of but half the test is not a user of the whole of the law and here has resulted in a misinterpretation of it. As said by Lindley, *J.*, in *In re Miner*,[19] in commenting on the interpretation of the act, "The proper interpretation of the act cannot be reached by the consideration of isolated sentences or paragraphs or even isolated sections; but the act must be considered as one comprehensive declaration of intention by Congress."

16. 318 Ill. 585 (1925).

17. *In re Brand's Trust*, 281 N.Y.S. 548, 156 Misc. 312 (1935).

18. See *Miller* v. *Miller*, 31 S.E. 2d 844 (1944) (where any interest in property is transferable under local law, including a beneficiary's interest in a trust, it passes to his trustee for the benefit of creditors).

19. 9 F. Supp. 1 (1934).